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PROBLEMS IN BANGLADESH

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Formal lenders in many low income countries, including Bangladesh, have problems recovering rural loans. Numerous equivocal loan recovery measures and inadequate information often make it difficult, however, to determine the exact magnitude of these problems. Seldom do lenders in these countries have information that gives a clear idea about aging of arrears, and as a result, some observers have argued that recovery problems are not serious because most overdues are repaid in reasonable periods of time after the loans' due date [Shukla].

The objective of this study is to document the severity of rural loan recovery problems in Bangladesh. Official data as well as preliminary information from a representative sample of formal rural loans made in Bangladesh from 1979/80 to 1983/84 are used in the analysis. We also calculate the aging of arrears on these sample loans to show what proportion of the loans are repaid on time or are repaid within several years after the due date. Caution must be used in interpreting our results because we are in an early stage of our analysis.

The presentation is organized as follows: the next two sections review the loan recovery problems on industrial loans in Bangladesh and also present a description of the data used in this paper for an analysis of agricultural loan recovery. This is followed by a discussion of agricultural loan recovery in Bangladesh using both loan survey data as

well as general information on loan recovery collected by the Bangladesh Bank (BB). We end our discussion with a few conclusions based on our analysis to date.

Recovery of Non-Agricultural Loans

Between 1973 and 1983 formal loans in Bangladesh increased in nominal value by over 600 percent, from Tk. 28 crores (U.S. \$36 million) in 1973 to Tk. 578 crores (U.S. \$231 million) in 1983. These loans have gone primarily to the manufacturing and the wholesale-retail sectors. They received 33 percent and 22 percent of the value of advances made in 1983. The agricultural sector is now the third largest recipient of formal loans, however. Its share increased from a meager 9 percent of the takas advanced in 1976 to almost 22 percent of the value of loans made in 1983 [Sobhan and Fatmi]. While the volume of loans has rapidly increased in nominal value, loan recovery has become an endemic problem in all sectors. The agricultural sector's recovery performance, although dismal, appears to be better than that of the nation's other sectors.

Until recently, information on non-agricultural loan recovery by national commercial banks (NCB) has not been readily available to researchers. Sobhan and Fatmi, in attempting to study this issue, discovered that

there is no systematic cataloguing of these advances in terms of their recoverability and potential for default in any of the NCBs. Most of such information is scattered over all branches of NCBs across the country in volumes of information such as the individual ledgers maintained separately by each branch [p. IV.5].

The Bangladesh Institute of Development Studies is presently researching the loan recovery problems facing public financial institutions

(PFI) in Bangladesh. Owing to the lack of consolidated data for the NCBs, the researchers to date have concentrated their studies on the Bangladesh Shilpa Bank (BSB) and the Bangladesh Shilpa Rin Sangstha (BSRS) [Sobhan and Mahmood, and Sobhan and Ahsan, 1985]. These two PFIs provide funds to the public and private industrial sector. Since 1975 the majority of their loans has gone to private entrepreneurs. These two PFIs may be considered the industrial equivalents of the Bangladesh Krishi Bank (BKB). The recovery position of the BSB and the BSRS declined steadily between 1981/82 and 1983/84. Sobhan and Ahsan used two ratios to measure recovery: 1) cash recovery as a percentage of current dues during the period and 2) recovery as a percentage of current dues plus overdues. During 1980/81 BSB and BSRS recovered almost 50 percent of their current dues but only 20 percent of their current dues plus overdues. For 1983/84 the first recovery measure had fallen to 31 percent and the second to 11 percent. In other words, during the last year reported, the BSB and BSRS failed to recover over two-thirds of their current dues and almost 90 percent of their pending liabilities [Sobhan and Ahsan, 1985].

The poor recovery performance of these two PFIs has undermined their ability to function as self-financing institutions and forced them to subsist on foreign donor support. This increased reliance on foreign funds gives donors increased leverage "to dictate policy and institutional changes in the field of development finance" [Sobhan and Fatmi, p. 45].

Data Used In Study

This study utilizes data collected as part of the Rural Bank and Bank Users Survey (RBBUS) of the Rural Finance Project of the Bangladesh Bank,

conducted by Robert R. Nathan and Company. The RBBUS sampled branches of four NCBs and the BKB. The NCBs are Agrani, Janata, Rupali, and Sonali Banks. The portion of the data analyzed is referred to as the Borrower Records. A sample of 100 loans was taken from each of 100 branch banks, located in eight districts (Chittagong, Dhaka, Faridpur, Jamalpur, Jessore, Kushtia, Rajshahi and Rangpur) during 1985. These branches represent a stratified random sample of the approximately 3,300 rural branches present when the RBBUS was designed. Theoretically the sample population should have been 10,000 loans disbursed between 1979/80 and 1983/84 by the sampled branches. Owing to inputting errors at the branch level by field enumerators, by encoder errors, and to electric power failure problems, the preliminary data set consists of 8,787 loans. Loans that did not have complete information concerning the date of the loan's application, its principal, its first due date, and its last transaction date were then deleted from the data set. This left 7,070 loans, representing 82 branches, for analysis.

Table 1 presents the distribution of these seven thousand plus loans by size and loan type. As can be noted, about two-thirds (68%) of them were for short-term agricultural loans, 5 percent were for overdrafts, and 27 percent were installments and other types of loans. A majority of the loans (58%) were small loans of less than Tk. 2,500, 29 percent were medium sized loans, and only 13 percent were large loans. Overall, about half of the loans surveyed (51%) were in small, short-term agricultural loans.

As can be noted in Table 2, the total amount of money lent through these 7,070 loans was over Tk. 45 million. Of this amount, about one-fifth

Table 1
Number of Loans by Size and Type of Loan

Principal Amount of Loan in Taka	Total No. Loans	Type of Loan			TOTAL
		Short-Term Ag. Loans	Overdrafts	Installment and Other	
	No.	-----% of Total Number of Loans-----			
Less than 2,500	4,103	51	*	7	58
2,500 to 7,000	2,076	16	1	12	29
7,000+	891	1	4	8	13
TOTAL	7,070	68	5	27	100%

* Less than one percent

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary Data.

Table 2

Total Value of Loans by Size and Type of Loan

Principal Amount of Loan in Taka	Total Value of Loans (Tk. '000)	Type of Loan			
		Short-Term Ag. Loans -----	Overdrafts	Installment and Other	TOTAL
		-----% of Total Value of Loans-----			
Less than 2,500	5,535	11	*	1	12
2,500 to 7,000	8,369	9	1	8	18
7,000+	31,522	1	30	39	70
TOTAL	45,425	21	31	48	100%

* Less than one percent

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary Data.

(21%) went into short-term agricultural loans, 31 percent into overdrafts, and 48 percent into installments and other loans. Only 12 percent of the total value of loans went into the smallest loan size category, 18 percent into medium sized loans, and 70 percent into large loans. Overall, the loan volume (69%) was concentrated in large loans for overdrafts and for installment and other loans.

Information concerning type of loan by participating banks is presented in Table 3 (number of loans) and 4 (volume of loans). As can be noted in Table 3, in terms of number of loans, each bank gave out a majority of short-term agricultural loans. It is interesting to note that the BKB had the lowest percentage (55%) of these loans. However, it had the highest percentage (44%) of the installment/other type of loans, suggesting some of its loans are for longer-term agricultural installment loans. Sonali Bank has the highest percentage of short-term agricultural loans (83%) and is closely followed by Rupali Bank (78%).

In terms of amount of money lent, only Sonali and BKB devoted at least a quarter of the total value of their portfolio to short-term agricultural loans (Table 4). The majority of these two banks portfolio was invested in installment/other loans. Agrani's portfolio appears to be evenly invested in both overdraft and installment/other type loans (over 40% in each). The other two banks, Janata and Rupali, have concentrated their portfolios in overdraft loans (58% and 53% respectively) and to a lesser extent in the installment/other loans (29% and 36% respectively).

Looking at both Tables 3 and 4 it is apparent that a few loans account for a sizeable portion of at least two banks' portfolio value. Overdraft loans represent only 10 percent of Janata's loans but account for over half

Table 3

Number of Branches Surveyed and
Number of Loans by Bank and by Type

Bank	Total Number of		Type of Loan		Installment/ Other	Total
	Branches Surveyed	Loans Made	Short-term	Overdraft		
			Agriculture			
% of Number of Loans Made by Individual Bank						
Agrani	16	1,513	65	10	25	100
Janata	12	933	60	10	30	100
Rupali	6	415	78	7	15	100
Sonali	25	2053	83	2	15	100
BKB	23	2,156	55	1	44	100
Total	82	7,070	67	5	28	100

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary data.

Table 4
Value of Loans Made by Bank and by Type

Bank	Total (Tk. '000)	Type of Loan			Total
		Short-Term Agriculture —% of Value of Loans Made by Individual Banks—	Overdraft	Installment/ Other	
Agrani	12,111	16	41	43	100
Janata	6,710	13	58	29	100
Rupali	6,362	11	53	36	100
Sonali	9,327	35	9	56	100
BKB	10,914	25	8	67	100
Total	45,425	21	31	48	100

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary data.

of its portfolio's worth. Rupali has an even lower percentage of its loans as overdrafts, seven percent, whose associated value accounted for 53 percent of its loans. Short-term agricultural loans represent 60 percent of Janata's loans and 78 percent of Rupali's loans, but they only account for 13 and 11 percent respectively of total loan value.

An overall analysis of the 7,070 loans showed that the number as well as total value of agricultural loans has declined over the period studied. Between 1979/80 and 1983/84 these loans gradually declined from 91 percent to 51 percent of the total number of loans. For 1984/85 loans, small loans accounted for only one-fifth of the total number of loans. In terms of value, there was also a rapid decline between 1979/80 and 1983/84, from 44 percent to 14 percent of all loans. Small loans accounted for only two percent of the value of 1984/85 loans. Only part of this shrinkage of the importance of small loans can be explained by inflation.

With the decline in importance of small loans, the importance of medium and large loans has gradually increased. The former from seven percent of the number of loans in 1979/80 to 43 percent in 1984/84, and the latter from two percent to 37 percent during this period. Between 1979/80 and 1983/84 medium sized loans accounted for approximately one-fourth the value of the portfolio. In 1984/85 these loans accounted for less than one-tenth (9%) of the portfolio's total value. The value of large loans has increased in their share of the portfolio over the years. In 1979/80, these loans accounted for less than half (41%) of the portfolio's total value. By 1984/85 these loans accounted for almost nine-tenths (89%) of the sample's value.

Loans made in 1983/84 and in 1984/85 represent two-thirds of the total value of the 7,070 loans studied. Thus, the value of the loans is not evenly distributed among the years studied.

Official Agricultural Loan Recovery Data

Official recovery information for agricultural loans in Bangladesh is presented in Table 5. These recovery rates measure the current recoveries as a percentage of current dues plus overdues including principal and interest due. In other words, Sobhan and Ahsan's earlier mentioned second loan recovery measurement. However, this measurement has its limitations: it combines flow figures, current recoveries and dues, with a stock figure, past overdues. If the latter represent a large proportion of a bank's loan portfolio, its reported recovery rate will decline even though it was able to recover most current loans as they came due. For this measurement technique to be meaningful, it must be accompanied by a policy of writing-off old overdue loans.

During the seven year period shown in Table 5, the banking system, as a whole, recovered less than half of its loans coming due and overdue. The bank-wide recovery position peaked in 1980/1981, with a stated recovery position of 49 percent. During 1978/1979 three of the four NCBs recorded their highest recovery position. Rupali Bank was the exception.

As can be noted in Table 5, the BKB has maintained the highest recovery rate of the five banks for most years. For the first six years it achieved a recovery position of at least 50 percent. During two years it recovered more than two-thirds of its current dues and overdues. One possible explanation for the BKB's higher recovery ratio could be the

Table 5

Official Agricultural Loan Recovery Position by Bank and by Year*

Bank	Year							
	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86**
	(Percent)							
Agrani	41	30	27	28	34	37	37	21
Janata	53	32	35	39	43	33	32	22
Rupali	25	23	15	34	10	25	17	13
Sonali	48	36	38	31	37	39	32	20
BKB	54	56	68	68	50	50	44	32
Total	45	42	49	48	42	42	38	25

* Recovery is measured as loan payments received (LR) during a given period as a percent of loans due during that period (LD) plus previous overdues (LPD). Symbolically this percentage would be:

$$\frac{LR}{LD + LPD} .$$

** The 1985/86 figures are only up to April 1986.

Source: Bangladesh Bank, Agricultural Credit Department. Unpublished data.

rolling-over of many of its loans, particularly its larger loans. In 1984/85 bank policy was changed and roll-overs were no longer permitted. In this year BKB's recovery position fell below 50 percent and declined even lower the following year.

The official data show that the recovery of agricultural loans by these banks is dismal, even though it is better than the performance on recovering industrial loans made by BSB and BSRS. Clearly the vitality of the entire financial system in Bangladesh is threatened by these widespread loan defaults.

RBBUS Loan Recovery

This section presents preliminary findings on loan recovery performance among the 7,070 RBBUS loans. As mentioned earlier, the total principal value of these loans amounted to about Tk. 45.4 million. As can be noted in Table 6, the loan recovery problem is chronic and widespread among the banks and borrowers covered by the RBBUS. The average value of loan principal recovered by the five banks was less than 40 percent in all of the years covered. For example, of all of the sampled loans made by the five banks in 1979/80, only an average of Tk. 33 had been repaid by March 1986 of each Tk. 100 lent in 1979/80. The low loan recovery of only 17 percent for 1983/84 reflects bad weather and government forgiveness of interest payments on loans. It should be remembered that the percentage figures for the last two years in the table underestimate the amount of eventual loan recovery because of late loan repayment and loans that were not due by the cut-off date of March 1986. Aside from the very low loan recovery rates for 1983/84, it appears there has been no improvement over

Table 6

Percentage of Original Loan Value Recovered
by Bank by Fiscal Year of Loan Application*

Bank	Year								TOTAL
	Before 1979/80	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	
Agrani	6	58	73	28	24	13	28	33	24
Janata	4	18	12	24	33	14	30	15	10
Rupali	1	61	25	68	44	31	20	30	25
Sonali	**	10	42	29	31	20	16	32	23
BKB	12	22	24	29	30	16	8	38	17
Yearly Percentage	4	33	38	29	29	17	19	27	22

* 1985/86 data as of 31 March 1986. The percentage measured here is the principal recovered (Pr) divided by the loan principal (L). The former is a flow variable while the latter is a stock variable. The percentage is $Pr/L \cdot 100$.

** Percentage is less than one percent.

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary data.

the 1979-85 period in the dismal loan recovery performance of the five banks surveyed. Likewise, all of the banks have recovered only a quarter or less of the money they have lent over the period studied.

Preliminary information on the aging of arrears among the 7,070 RBBUS loans is shown in Table 7. As can be noted, about one-third of these loans (37%) had been repaid on time or were not due for payment by March 1986. Another one-third of the value of the loans was in arrears for less than one year. Approximately one-third (29%) of the loans were overdue by more than one year. Overall, we conclude that 40-50 percent of the value of these surveyed loans may not be collected.

A separate arrears analysis of just the short-term agricultural loans included in the survey showed the following results: the total value recovered on these loans made in 1979/80 was 68 percent by March 1986. This percentage steadily declined to 52 percent in 1982/83, to 33% in 1983/84, and to 16% in 1984/85.

Conclusions

As mentioned earlier, one must be careful in interpreting the results reported in this paper because of the preliminary nature of the analysis. Nonetheless, the results show a discouraging picture of loan recovery in Bangladesh. While a significant amount of the overdue loans appear to dribble in for repayment within the first year after the due date of the loan, a very substantial amount of the loans are repaid much later, or not repaid at all.

It is particularly discouraging that the loan recovery performance on short-term agricultural loans appears to have deteriorated substantially

Table 7

Repayment Status of RBBUS Loan Value by Bank and by Aging of Arrears

Bank	Paid on Time or Not Due Yet	Aging of Arrears						Total
		1-30 Days	30-90 Days	90 Days- 1 Year	1-2 Years	2-3 Years	More than 3 Years	
-----Percentage of total value of bank loans surveyed-----								
Agrani	54	3	3	17	17	3	3	100
Janata	35	3	4	23	7	6	22	100
Rupali	7	2	3	48	35	3	2	100
Sonali	41	2	3	23	15	9	7	100
BKB	32	4	6	28	16	8	6	100
TOTAL	37	3	4	26	17	6	6	100

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary data.

over the past few years, and that the rural financial system appears to be shifting to larger loans.

Some policy makers are cavalier about these kinds of problems and argue that defaults are an innocuous way of helping farmers, especially the rural poor. These individuals overlook the fact that defaults scar both lenders and borrowers, and also is a regressive way of distributing subsidies. Loans not repaid decrease the funds intermediaries have available to lend, make it difficult to assure safe deposits and to attract savings, absorb scarce managerial time, undermine the financial integrity of the lender, and tarnish the intermediary's reputation. Persistent defaults also cause financial intermediaries to be perceived as transitory rather than permanent institutions. Borrowers who default essentially vote against the future services that the intermediary might provide.

While less well recognized, loan defaults also damage defaulters. A single loan or deposit has relatively little value to most individuals. What is valuable is a flow of dependable financial services that extends over many years. The relationship between intermediary and client should evolve over time and not be a single event. This relationship may start with the client making a deposit. The next step may be the client getting a small short-term loan. Later, as the size of the borrower's firm increases and the lender's knowledge about the borrower increases, the relationship may evolve to large deposits, larger loans, and loans over longer periods of time. The end result of this process is a client with greater debt capacity than when the relationship began. When an individual does not repay a loan the process of expanding debt capacity is reversed: the capacity is destroyed. While the volume of loans handled by

intermediaries are the most commonly cited measure of the products created by financial markets, the increase in debt capacity among borrowers is the true measure of a financial markets contribution to development.

Loans that are not recovered, therefore, are doubly damaging: they undermine the vitality and ability of financial markets to carry out their basic function of supporting economic activities, and they also destroy the most important product that financial markets create: debt capacity. Overall, loan recoveries are the main determinant of the ability of a financial market to support economic development. Bangladesh's rural financial markets will rapidly lose that ability unless loan recovery performance is substantially improved.

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